TAXATION

A REVIEW AND RECOMMENDATIONS

FOR REFORM

EXECUTIVE SUMMARY

FINAL REPORT TO THE
GOVERNMENT OF MANITOBA
November, 1986

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EXECUTIVE SUMMARY

FINDINGS

The Canadian income tax system, both personal and corporate, is in need of urgent reform. By loading a myriad of objectives onto the tax system, successive federal governments have created an unworkable, unfair situation for taxpayers and fiscal crises for governments. The unfairness of this situation is evident by even a casual observer of events in our nation. Wealthy Canadians and large corporations, aided by skilled lawyers and advisors and because of an Income Tax Act containing a bewildering array of special preferences and inequities, have been able to avoid paying their fair share of taxes. Working Canadians of moderate income have been compelled to bear an unfair burden of taxation. Low income Canadians have been hurt by program cutbacks caused by fiscal pressures and by regressive tax changes. A broadened tax base with a greatly reduced number of tax expenditures is a necessary objective for reform.

Our economy also has changed dramatically and inexorably from one dominated by resources and manufactures to one in which services provide the vast majority of jobs and activity. This economic transformation provides an additional reason for broadening the tax base in the interests of fairness and equity.

REVENUE

The own-source revenue of the Manitoba Government has grown dramatically from its modest beginnings of a few hundred thousand dollars annually. As recently as the 1940's specific provincial tax measures were small in number and financial impact.

Apart from income taxation, the first notable tax intervention that plays a major role in the current revenue mix was the introduction of the gasoline tax in 1923. Revenue from this tax has grown from less than $10 million in the mid-1950's to an estimated $115 million in 1986-87.

The most dramatic revenue increases over the past two decades were gained from the taxes on tobacco and retail sales and from the levy, three measures which are now responsible for 36% of the total estimated (1986-87) $1.9 billion in revenue from taxation. The largest contribution to taxation revenue is from the Corporation and Individual Income Taxes, which are estimated to have a collective impact of $866 million in 1986-87.

In addition to the province's taxation measures, other sources of revenue have evolved in the area of fees and charges for a variety of government-delivered services. The major fees and charges will total $310 million in 1986-87 and include land titles fees ($11 million), the Liquor Control Commission revenues ($145 million), automobile and motor carrier licences and fees ($30 million), drivers' licences ($6 million), water resources charges ($31 million), and parks fees ($5 million).

Revenue from the Government of Canada includes $232 million for a range of capital shared-cost and other programs, $510 million for equalization and $434 million for established programs financing, for a total of $1.2 billion in 1986-87. This represents 35% of the projected 1986-87 total revenues of $3.4 billion compared to the provincial own-source revenue level of 65%.

The declining federal share of the cost of Manitoba government operations presents major difficulties for the province. Its impact is especially important considering the role of federal contributions in supporting just the priority core programs of government.

The evolution of the province's revenue base is clearly going to continue in the context of a number of distinct trends and adjustments:

a. diminishing federal contributions;

b. increased reliance on provincial own-source revenues;

c. necessary enhancements to the provincial own-source revenue base.

ECONOMIC GROWTH

Manitoba's economy is not immune to the national and international cycles of recession and growth. With the rapid movements of interest rates, commodity prices and the dependence on trade of the larger Canadian economy, we are influenced by the American economy to a tremendous degree. However unpredictable those impacts may be, the next 5 to 10 years in Manitoba offer the prospects of solid, sustainable economic growth. Major investments in hydro-electric development at the Limestone and Conawapa projects and urban redevelopment of the Core Area, North Portage and East Yards areas are likely to underpin a stable period of increasing activity. Despite severe difficulties in the farm and mining sectors the overall prospect is encouraging.

Of particular note is the approximately 3% annual average growth rate forecast for real gross domestic product over the next 5 years. Manitoba should enjoy a reasonably steady period of economic growth supported by investment and population trends.

NEW SOURCE POTENTIAL

In conducting this review a wide array of possible new revenue sources was considered. The following specific possibilities are discussed as worthy of serious review, although not all are recommended for implementation.

WEALTH TAXES

Beginning in 1893, succession duties and gift taxes provided a direct taxation of wealth. Provinces imposed their own succession duties from 1893 to 1941 when the federal government undertook national measures while sharing revenues with the provinces. In 1972, the federal government delegated the levies to the provinces. This delegation proved to be the undoing of wealth taxation in Canada. The 'house of cards' situation produced a gradual elimination of succession duties on a province-by-province basis.

In other nations succession duties are well accepted as part of the taxation system. An OECD report on personal income tax systems indicated that in 1983, seven countries -- Belgium, France, Greece, Japan, Portugal, Switzerland, and the United States -- received revenues in excess of .2% of their GDP from estate/inheritance/gift taxes.

In the interests of equity, wealth taxes should be the subject of a joint review by the Federal and Provincial Departments of Finance and considered as a component of the overall Tax Reform discussion.

NET INCOME TAX

Because of the myriad of special preferences, deductions and exemptions, an additional point of Provincial Personal Income Tax raises a relatively small amount of revenue (approximately $13.5 million). For this reason and because of the province's objection to many of the special preferences, the concept of a tax on Net Income has been under internal discussion for some time. Net income is a broader income base than Taxable Income.

The net income tax option appears to accomplish its intended objectives. The option discussed represents a reasonably progressive, income-related means of raising substantial added revenues. It also would put in place an additional revenue source, which with appropriate modifications to the definition of "net income", could be used to protect provincial PIT revenues from some federal tax-reducing changes, such as the capital gains exemption. As such, the measure appears to be consistent with the objectives of tax reform.

LAND TRANSFER TAX/LAND SPECULATION TAX

There are two potential taxation measures which could be imposed over and above the current fees levied by Land Titles for mortgage registrations and land title transfers.

First, a land speculation tax could be imposed as a capital gains tax on realty. Such a tax was in effect in Ontario from 1974 to 1978, imposed at a time when land prices were escalating. Principal residences, commercial properties, and some other properties were exempt. The measure

was discontinued in 1978 for three reasons: First, much lower than projected revenues; second, the decline in excess profits due to increases in interest rates; and third, the negative public reaction. If Manitoba was to consider a similar tax, it is unlikely that the revenue collected would be significant. Also, there would be negative consequences similar to those faced by Ontario in response to its action.

The second potential measure is a land transfer tax levied on the purchaser. Ontario currently has such a tax in place, with rates at the levels of: 1/2 of 1% on transfers of properties valued at up to $55,000, 1% on properties valued at $55,000 to $250,000, and 1-1/2% on single family dwellings or duplexes valued at more than $250,000. To determine with some accuracy the potential revenue of applying a similar tax in Manitoba, the estimated average annual transfer value in each category ($0 - $55,000; $55,000 - $250,000; $250,000 and over) would have to be known. That information is not available on a province-wide basis. However, if each of the estimated 100,000 transactions annually has an average value of $50,000, a 1/2% tax should net the province $25 million in additional revenues and cost the average purchaser $250. The appeal of such a tax would be its rough application to wealth. Imposition at a higher rate (eg. 1%) might be acceptable if it replaced the existing basic fees charged by Land Titles. Graduated rates such as Ontario's would be progressive and could be further considered.

LOTTERY PRIZES

The special tax exemption on lottery winnings has recently come under discussion in Ontario. An Ontario study on tax expenditures in that province estimated that taxing lottery winnings as income would return $72 million per year to the Ontario Treasury.

LOTTERY REVENUES

At present, lottery revenues do not flow to the Province's Consolidated Revenue. This is due to the relatively recent government management of the total gambling industry and the pre-existing allocations of revenues from that industry to a wide variety of community-based organizations. Total lottery revenues have grown at a much more rapid rate than other government revenues. The result has been a rapid growth in revenues for those particular activities and organizations funded by the Manitoba Lotteries Foundation. For example, in 1984-85, Lottery Foundation revenues increased to $65 million and profits increased to $22.86 million -- an increase of 45 percent as compared to growth in total government revenues of 6.1 percent between 1983/84 and 1984/85. While basic necessities such as health and education have been receiving moderate increases, other activities have had dramatically more rapid revenue increases due to the lottery source of their funding and for no other reason. This reality would seem difficult to explain rationally .

Reform to address this situation should be considered.

CROWN CORPORATIONS

A wide array of differential tax treatment exists for the various Crown Corporations. For example, the Manitoba Public Insurance Corporation pays Corporation Capital Tax while Manitoba Hydro and the Manitoba Telephone System are currently exempt. On the other hand, a 6% tax is levied on hydro and telephone bills but not on automobile insurance premiums. More consistent treatment should be considered. In particular, the extension of the Corporation Capital Tax to all Crown corporations and the indexation of Water Power Rentals could be sources of increased revenue.

Crown Corporations	Tax on Goods/Services	Corporation Capital Tax	Other Charges Or Items
MANITOBA HYDRO	6% Revenue Tax	EXEMPT	Water Power Rentals to Province.
MANITOBA TELEPHONE SYSTEM	6% Revenue Tax	EXEMPT	
MANITOBA PUBLIC INSURANCE CORPORATION	EXEMPT	TAXABLE	Insurance Corp. Tax (on all premium income.)
MANITOBA LIQUOR CONTROL COMMISSION	12% SALES TAX	TAXABLE	Net Profits to Province

LUXURY TAX

The Working Group discussed possible luxury tax options or a higher rate of Sales Tax on luxury goods. For a variety of reasons, both conceptual and administrative, this idea was not pursued further.

TAX EXPENDITURES

An emergent and extremely important issue in tax policy is the prevalence of tax expenditures. Simply stated, tax expenditures are deviations from a broad tax base which forego the collection of taxes otherwise due. In a recent report, the Auditor General of Canada estimated that 35 to 50 billion dollars of tax expenditures existed in the Federal taxation system.

At the Provincial level, the Manitoba Government published a list of tax expenditures in its 1986 Budget and Saskatchewan published its own slightly different list in 1985.

In its 1986 review of tax expenditures, the Manitoba Department of Finance compiled the following analysis of the magnitude of direct expenditures vs. tax expenditures in the 1983 - 85 period.

MANITOBA
DIRECT EXPENDITURES AND TAX EXPENDITURES
BY EXPENDITURE CATEGORY, 1983-85

($ Millions)

EXPENDITURE CATEGORY	DIRECT EXPENDITURES			TAX EXPENDITURES		
	1983	1984	1985	1983	1984	1985
Education	618.6	654.4	663.3	6.2	7.3	7.5
Health	1,023.1	1,082.0	1,136.4	12.8	14.5	15.7
Economic, Social and Employment Security	472.7	515.6	566.9	262.6	273.0	282.0
Economic Development	602.5	600.6	593.2	270.5	305.9	296.7
Direct Local Government and General Government Services	327.8	339.4	395.5	0.1	0.1	0.1
Other	282.0	265.7	263.0	1.0	1.1	1.1
TOTAL	3,326.7	3,457.7	3,618.3	553.2	601.9	603.1

As could be seen in this chart, the totals for tax expenditures are significant, amounting to nearly 14% of direct expenditures.

A careful review underscores the major concern about the nature of tax expenditures. Because for the most part they are buried in the legalese and fine print of tax legislation, tax expenditures do not receive the same intensity of legislative or parliamentary scrutiny as direct expenditures. Often they are completely apart from the estimates review process which, at least provincially, has the capacity and frequently the perseverance to question tiny direct expenditures. Were tax expenditures capable of being scrutinized effectively the public policy concerns about them would be greatly reduced.

THE FEDERAL-PROVINCIAL RELATIONSHIP

Revenue received by the Provincial Government from the Federal Government takes several forms, including:

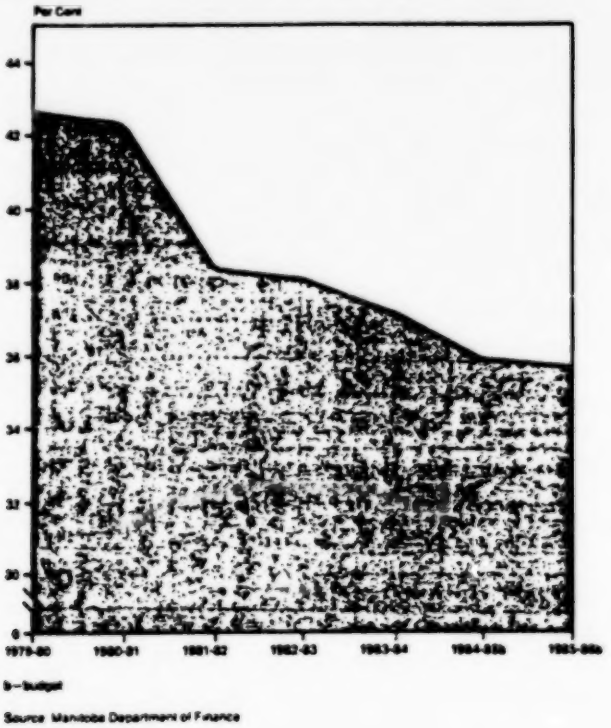
		1986/87
o	Shared Cost Programs	$232.0 million
o	Equalization	$510.8 million
o	Established Programs Financing (EPF)	$434.0 million

In addition, the Federal Government collects Provincial Corporate and Personal Income Tax without administrative charge to the Province.

In total, the Province receives 35% of its revenue from the Federal Treasury. Recent trends have been towards a decline in the Federal share.

Federal Transfer Payments to Manitoba, 1979-80 to 1985-86

Percentage of Total Provincial Revenue



CURRENT FEDERAL INTENTIONS REGARDING TAX REFORM

Since Finance Minister Wilson's summer tax reform announcement, the Federal Government has added a third element to the two reforms already underway. In addition to the reviews of the Federal Sales Tax and the Corporate Income Tax already in progress, a review of the Personal Income Tax system will now be undertaken. Current indications are that the three components are now seen as a "package" to be unveiled together although not necessarily implemented simultaneously.

The federal work is at various stages of preparedness. The Business Transfer Tax which will replace the existing Federal Sales Tax is designed and only requires final decisions on rate levels.

The Provinces might be offered a share in Business Transfer Tax revenues <u>if</u> they agreed not to occupy tax room created by the Federal Government lowering personal income tax rates. This proposal might have the positive result of reversing the trend of a shift in tax burden from corporations to individuals. However, it would do nothing to remedy existing inequities in

the corporate and personal income tax systems. Without knowing the amount of net incremental revenue available to the Province it is difficult to come to a conclusion on this aspect of the Federal reform. A major "hidden" tax such as the Business Transfer Tax certainly is at best a mixed blessing, with its lack of visibility more pleasant for its sponsors than for Canadians generally.

EQUALIZATION

One of the most important financial bonds of the Canadian Confederation is the principle of Equalization. Enshrined in Section 36 of the Canadian Constitution, the intent of equalization is to ensure that provinces have sufficient revenue to provide reasonably comparable levels of services to Canadians living in the divergent regions of our nation at reasonably comparable levels of taxation. First advocated by the Rowell-Sirois Commission the principle has been widely, if not universally, accepted in Canada. Now the debate is over the reality of equalization as delivered by the program and formula. Subject to Federal-Provincial negotiation and general consensus, if not unanimity, the basis of the equalization formula had broad support until the 1982 amendments by the Federal Government. Proceeded with unilaterally, the new Federal formula eliminated the all-province national average and implemented a so-called "representative average" of only five provinces (B.C., Saskatchewan, Manitoba, Ontario and Quebec).

Concern and vigorous protest by the Provinces over the impact of this change caused the Federal Government to cushion the impacts by putting in place transition arrangements .

Manitoba faced the largest percentage cut in its support level. As a result, the Province mounted a most vigorous and eventually successful effort to have transitional assistance extended.

Equalization is of vital importance to Manitoba, comprising about 15% of of total revenue and over 40% of total Federal transfers to the Province. Manitoba will need to remain a vigorous proponent of an equalization formula which is consistent with this principle.

Under the 1982 changes, Manitoba was the Province "hardest hit." This situation has been ameliorated by temporary supplementary payments; however, a change in the formula will be required to maintain both the principle and the reality of equalization.

ESTABLISHED PROGRAMS FINANCING

The findings of this review are entirely in harmony with Setting Priorities Straight - Manitoba's Position on Federal Reductions in Funding Health and Higher Education published by the Province in June, 1986. The Working Group concurred with the paper's conclusion:

"Bill C-96 will deeply and adversely affect provinces' ability to sustain services. Its introduction clearly suggests to provinces that the unilateral actions so deplored in previous administrations can be expected to continue in this one. It also sets the stage for acrimonious debate on many aspects of the "Nielsen Report". But, most of all, it is unnecessary. The federal government has moved to secure $35 billion in new tax revenues by 1990/91. At present, some 11.1% of federal revenue goes to health and higher education. If only 10% of the new funds were so allocated, needs could be met and cooperation in trust would be once again possible. The Government of Manitoba therefore calls upon your Committee to recommend the removal of Bill C-96 and its replacement with federal leadership, planning and fair federal funding for health and higher education."

THE MUNICIPAL INTERFACE

Over and above the tax credit payment programs, the Manitoba Government's primary means of transferring revenues to the local government level has been the Provincial-Municipal Tax Sharing arrangement, which in 1986 involved total payments of $35.5 million.

Other major transfers of funds to local governments are the $47.6 million in operating and capital grants paid to the City of Winnipeg, the $24 million paid as grants to municipalities in lieu of taxes (which are supplemented by similar payments made by provincial Crown corporations), and the $14 million Local Government General Support Grant.

Added to the cost of the property tax credit programs, these transfers total more than $200 million in 1985-86. The most significant potential for major changes involves the property tax credit programs.

The current system of property tax relief provided through the tax credit programs represents a significant reduction in effective property and school tax burdens for all groupings of households and is quite progressive in its overall impact. The cost of the program is projected to be $85.5 million in 1987-88: $75.5 million through the Resident Homeowners' Tax Assistance Program ($325 minimum credit) and $10 million through the Pensioners' School Tax Assistance Program (up to $175 additional relief).

The Province's options for reducing this program cost must be reviewed in the context of the impact of reassessment, particularly the impact in Winnipeg. Although the City of Winnipeg will be empowered to cushion the impact (i.e. through the application of measures to avoid the transfer of tax burden from commercial to residential property), it is not clear that the action taken by the City will be sufficient for all homeowners facing a significant property tax increase. Reduction or elimination of the minimum $325 credit will translate into a significant tax increase, especially when combined with any increases resulting from reassessment.

The options for cost reductions in the area of municipal transfers are significant in both number and impact. The most acceptable of these appears to be a reduction of the $325 minimum to a lesser amount. The potential savings to the Province are in the range of $7 to $22 million per annum. Reduction in the minimum is the least regressive of the available options.

REFORMING THE INCOME TAX SYSTEM

CORPORATE INCOME TAX

The major findings on the Corporate Income Tax are that the absence of a sufficiently broad-base and a myriad of special preferences are major problems. As noted in a recent report:

> *"Tax Probe '86's major conclusion from its series of hearings is that Canada's existing corporate tax system is a chaotic, unsystematic, unplanned, ad hoc collection of subsidies, loopholes, rate exemptions, special credits and special allowances which defies logic and all but beggars description. This may seem like a harsh and, perhaps, overly partisan judgement, but it is one which has been reached not just by us, but by virtually all the tax experts and interested groups to whom we spoke.*
>
> *The corporate income tax system's primary role as a generator of revenues with which to pay for government services has been undercut, particularly since 1971, by a proliferation of tax expenditures, by which we mean special provisions for rate reductions, exemptions, deductions and the like which have involved a loss of public revenues which would otherwise have been collected and thus deserve to be analyzed and justified in the same way as normal, budgetary expenditures.*
>
> *Many of these special measures were designed to stimulate investment -- and hence growth and jobs -- by reducing the real cost of new capital spending by corporations -- but it is clear from evidence gathered by Tax Probe '86 that few, if any, criteria exist to judge whether such measures have worked. There is, indeed, considerable evidence to the contrary, and we have found that there is now a surprisingly broad consensus among tax experts and businessmen that we need a simpler and less discriminatory system which would allow "the market" rather than the tax system to determine appropriate levels of investment...*
>
> *...A surprising preliminary conclusion to be drawn from the Tax Probe'86 hearings on the corporate tax system is the near unanimity that the many changes introduced since 1972 have not well served the stated objectives of building a more productive and dynamic economy with high and stable levels of employment. We found few -- we could say no -- defenders of the existing system. Indeed we have had great difficulty finding a tax expert or businessman willing to defend a single existing corporate tax expenditure program."*

PERSONAL INCOME TAX

The Provincial Income Tax of 54% (2.2% for municipal purposes) is levied on the base of Basic Federal Income Tax payable. Therefore, any exemptions, deductions or credits against Federal Income Tax implemented unilaterally by the Federal Government affect the Province's revenues.

Often the philosophical basis for new Federal tax measures is not shared by the Province and the revenue loss disrupts the Province's ability to manage its fiscal situation.

There are a number of Federal Personal Income Tax measures which reduce Provincial Revenues and are not compatible with the Province's views on tax fairness and equity. These include:

Exemption For Capital Gains

The Federal Government in its 1985 Budget introduced an exemption from income taxation for capital gains. The exemption is to be phased in over six years to reach $500,000 in 1990. Capital gains above the exemption level will continue to be taxed at 50% of the rate applicable to earned income. The cost to the Provincial Treasury is estimated to be $26.1 million in 1986. Due to the phase-in of the $500,000 exemption the cost in later years will likely be substantially higher. The inequity in the measure is evident and favours wealthy investors over other tax filers.

Scientific Research and Development Tax Credit

Although the "quick-flip" aspect of this provision which caused the worst abuses has been eliminated, the S.R.T.C. must be regarded as the most blatant recent example of the folly of Federal tax expenditure policy. Current estimates place the total cost at several billion dollars with a great deal of the subsidy flowing to office buildings and luxury automobiles rather than research and development. As the Federal Auditor notes, "The revenue drain associated with the Scientific Research Tax Credit was fuelled by taxpayers who bore little or no risk."

Non-taxation of one-half capital gains income realized after 1971

This provision had a cost nationally as follows:

1979	$570 million
1980	750 million
1981	570 million
1982	265 million
1983	440 million

In a five year period some $2.6 billion dollars of tax expenditure nationally resulted from this single provision.

These are but three examples, however blatant, among dozens that could be cited. All have the same derivation and motive noted early in this Report - the attempt to achieve investment stimulus objectives through the tax system. Equally clear is the Auditor's assessment of the inefficiency and lack of accountability which is a consequence of these tax expenditures. Of greater concern is the inequity created among taxfilers with similar incomes who, as a consequence of these measures end up paying widely varied levels of tax. As noted in the report, there is also the extremely unfair and regressive expenditure cuts brought about by resultant fiscal pressures on governments.

PROGRESSIVITY

Manitoba's tax system is somewhat more progressive than those of other Canadian provincial jurisdictions. This is due both to a number of elements that allocate a larger share of the tax burden to those individuals and institutions with a greater ability to pay and to tax credits geared to incomes. Some of the elements include:

- MANITOBA PROPERTY TAX CREDIT
- MANITOBA COST OF LIVING TAX CREDIT
- HIGH INCOME SURTAX
- ABSENCE OF MEDICARE PREMIUMS
- ABSENCE OF HOSPITAL USER CHARGES

Of significant concern is the continued improvement of the tax system by the introduction of greater progressivity in any reform measures. To properly measure progressivity of the total impact of various taxes and programs, it is necessary to consider tax back rates or rates of reduction in program benefits as well as marginal tax rates and credits.

RECOMMENDATIONS

The recommendations of this report have at their core the view that Manitoba must strongly advocate the reform of the Federal taxation system. In the absence of success in this pursuit the Manitoba Government will need to both reform and increase taxation within its own jurisdiction to address its fiscal situation while preserving important social and economic services.

The specific recommendations of the report include the following:

MODEL INCOME TAX

o advocacy of a "model" national income tax system by the Province with features such as a very broad definition of income; minimum corporate and personal income tax provisions; the elimination of a large number of exemptions and deductions; the conversion of other deductions to tax credits.

- the model income tax would have fairness and equity as its organizing principle with the treatment of all income in the same manner as a key operating principle.

The most significant changes that could be enacted in a model income tax system would be the conversion of various exemptions to credits. The enhanced equity possible through such conversions is based on the greater value of existing exemptions to upper income groups. For example a $4,000 basic personal exemption might be worth as much as $1,800 in tax saving to a high income earner and as little as $600 or less to a low income individual. Conversely, a tax credit would be worth more to the low income individual.

MANITOBA STRATEGY ON FEDERAL TAX REFORM

It is recommended that the Manitoba Government approve a positive position on reform of the Personal Income Tax system and Corporate Income Tax system along the lines suggested. (Model Income Tax System). It is further recommended that the Province utilize every available opportunity to present and advocate its view.

Manitoba has articulated its critique of the Federal Government's tax decisions on numerous occasions. Manitoba, in its many statements, has laid the groundwork for concrete proposals for reform of the income tax system - both personal and corporate. Manitoba's views on the need to broaden the base and eliminate tax expenditures has been a recurrent theme. The necessary next step is to articulate the model for a fair and effective taxation system, one which provides sufficient revenues obtained in the fairest possible manner.

INCREASING THE LEVEL OF FEDERAL REVENUE TRANSFERS

It is recommended that the province continue its efforts to reverse the Federal Government's reductions in the Health and Post Secondary Education area. No Province has done more to pursue this issue. The initiative should be continued.

All further opportunities should be pursued on this issue including meeting of Finance, Health, Education Ministers, and First Ministers. As recommended above the development of a parallel and complementary initiative on tax reform should enhance the credibility of the current position by elaborating in even greater detail the sources of revenue available to the Government of Canada. Again the support of other provinces and the broader public will be important elements of a continued campaign.

WEALTH TAXES

In the interests of equity, it is recommended that the Province advocate a joint review of wealth taxes by the Federal and Provincial Departments of Finance as a component of the overall Tax Reform discussion.

OPTIONS TO REFORM CURRENT TAX REVENUE SOURCES

It is unlikely that Federal Tax Reform will proceed at a rapid pace. Because of the divergent philosophies of the Governments of Manitoba and Canada, it is also quite likely that the Federal Tax Reform which does proceed will have somewhat different concerns than treating all forms of income in the same manner and with overall progressivity. To date, the actions of the current federal government in this regard have been mixed . Elimination of the Scientific Research and Development Tax Credit and imposition of an Alternative Minimum Tax are steps which will increase the progressivity of the tax system while the $500,000 Capital Gains Deduction is regressive in its impact. In view of its fiscal situation, it is recommended that the Province consider the following package of tax reform and tax increase options with the objective of raising necessary incremental revenues in the most equitable fashion available.

RETAIL SALES TAX EXTENSION OPTION

It is recommended that consideration be given to extending the Retail Sales Tax to the following services within the Manitoba economy after a careful further review of implications.

- Legal Service Fees
- Accounting Service fees
- Engineers and Architect Service Fees
- Automobile Insurance Premiums
- Personal Care Services
- Domestic and Other Custodial Services
- Management Consulting Fees

Further work is necessary on a number of aspects of this proposal. This work should be undertaken by the Department of Finance, Taxation Division at an early date. The work should include necessary legal drafting.

It is further recommended that consideration be given to extending the Retail Sales Tax to tobacco products to yield an estimated incremental $15 million per annum.

LEVY FOR HEALTH AND EDUCATION

It is recommended that consideration be given to increasing the levy by .5 or 1.0% of payroll. This would yield $82 million per annum (1%) or $41 million (.5%). On a net basis, excluding payments by local governments and the Province itself, $60 million or $30 million in additional revenues would be raised.

The levy has the distinct advantage of being levied on the Federal Government and large corporate employees. It has the disadvantage of being unpopular with small business and potentially a perceived deterrent to job creation by

small business. As small businesses are providing 70 - 80% of new jobs in the Province this is an important consideration. For this reason it is further recommended that the current exemption from the levy be increased from $50,000 to $100,000. This would eliminate the levy for more than 3,500 small businesses. The estimated cost of this measure would be $3.0 million per annum.

As the small business sector has been the source of most new job generation and should continue to make a strong contribution to job creation, these changes are intended to assist that job generation.

RETAIL SALES TAX

The Retail Sales Tax should be considered as a potential element of a revenue raising package. Due to the broad exemption of food and some clothing part of the regressive impact of the sales tax has been mitigated. The Cost of Living Tax Credit also provides an offset for many Manitobans.

Of the available revenue sources, only the Retail Sales Tax and the Income Tax offer a sufficiently broad base to generate significant incremental revenues. If the Retail Sales Tax is to be the vehicle for a revenue increase, then it is strongly recommended that an exemption be considered for all clothing and footwear purchases under $300. At a cost of $36 million per annum (8% rate) or $31.5 million per annum (7% rate) or $26.5 million (6% rate), this exemption would represent a somewhat progressive reform of an essentially regressive tax.

An incremental 1 point of Retail Sales Tax and the equivalent change in the rate applied to alcohol would raise revenue of $75 million per annum and 2 points would yield some $150 million.

CHANGES TO CURRENT FEES AND CHARGES

The major requirement is that more consistent attention be devoted to this complex and important area of revenue policy. The Provincial Treasury receives $310 million per year from various fees and charges or about 10% of its total revenue. Quite properly, Departmental personnel most knowledgeable in the specific policy area are the key source of advice on the level of charges. However, they are currently, for many fees and charges, the only source of advice.

It is recommended that one staff analyst within the Treasury Board Secretariat be assigned to fees and charges full time for one year.

It is further recommended that all departmental managers responsible for administering particular fees and charges be given 60 days to report on the full implications of each of the following changes in fee levels.

* complete elimination (administrative savings versus revenue losses).

* maintenance at current levels (degree of subsidization involved).

* increase by 25%.

* increase to equal highest rate charged in another Provincial jurisdiction.

Finally, it is recommended that the results be analyzed and presented in the form of a Report on Fees and Charges in January and that one omnibus increase/reduction/elimination package be approved, to be effective April 1, 1987.

NEW REVENUE SOURCES

NET INCOME TAX

As noted earlier, a tax on net income is one option. The following comparison includes this option versus a sales tax increase versus an increase in the general personal income tax.

The table below shows the approximate impact of a 2 point sales tax increase, a 10 point increase in the general personal income tax rate and the 1987 tax on net income concept.

Income Group ($)	2 Point Sales Tax Increase as % of Income (%)	10 Point Income Tax Increase as % of Income (%)	Net Income Tax as % of Income (%)
Under - 7,500	0.76	0.03	(0.03)
7,500 - 15,000	0.80	0.52	(0.01)
15,000 - 25,000	0.78	0.94	0.79
25,000 - 50,000	0.66	1.25	1.30
50,000 & Over	0.58	1.74	1.49

This table is based on the questionable, though unavoidable, assumption that taxpayers would not make behavioral changes in response to any of the increases, such as the increased use of tax shelters.

For equity reasons, it is recommended that careful consideration be given to this option.

A tax on net income of 2% with the low income offset would yield $115 million of incremental revenue in 1987/88.

LAND TRANSFER TAX

It is recommended that the Manitoba Government consider introducing a tax on the value of land transfers in the province. The tax of 1/2 of 1% of the value of the transfer would be charged to the purchaser and would provide additional revenue in the order of $25 million.

LUXURY TAX

Upon consideration, this concept, while appealing from an equity perspective, has too many definitional and practical difficulties. The most appropriate application would likely be to arbitrarily designate a number of categories of goods as well as price thresholds above which the luxury tax rate would apply. For example -- automobiles over $25,000; jewellery over $2,000; fur coats over $5,000; boats over $25,000.

It is recommended that the concept of a luxury tax not be further considered due to various difficulties that would be encountered in its administration.

TAX EXPENDITURES

It is recommended that the Legislative Assembly consider devoting one day of the eight days of debate on the annual Budget to debate tax expenditures. It is further recommended that the government table a Report on Tax Expenditures annually to serve as a focal point for the debate. It is suggested that this Report be tabled with the Budget.

As well, it is recommended that consideration be given to having sunset clauses in legislation for tax expenditures.

TAX AMNESTY

It is recommended that the Province of Manitoba consider adopting a tax amnesty program in its next Budget for its own taxes. The amnesty program would apply to individuals and small businesses. It should provide a period of time - 3 months - during which taxes under certain Provincial Statutes which have not been paid can be paid with only interest added and not penalties.

British Columbia achieved some success with a similar approach. The B.C. plan encouraged disclosures of taxes which had not previously been declared by taxpayers and forgave penalties on some for a given period. After that period, penalties were increased substantially.

CONSULTATION WITH EXTERNAL GROUPS

In recent years Manitoba Finance Ministers have initiated wide consultations on the overall fiscal situation of the Province and the choices faced by the Provincial Government. This is a welcome and important development. It is strongly recommended that such consultations be expanded and enhanced.

CONCLUSION

There is no magic in tax reform or in the field of taxation - no rabbits - no hats - and no magicians. Raising the revenues necessary for the purposes of sustaining the programs needed and wanted by the people of Manitoba is neither an easy or a popular challenge. No remedy can be fashioned for Manitoba's fiscal difficulties that does not include both reform of taxation and reform of expenditure management. In the absence of progressive and early movement by the Government of Canada on a major reform of the national taxation system which augments Provincial revenues, the Government of Manitoba will also need to increase taxation levels. Fairness must be the guiding principle in reform. Fairness and equity will need to be central in both the expenditure decisions which preserve essential services and in taxation decisions which determine the source of needed revenues.